IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 92 of 1985

For Approval and Signature:

Hon'ble CHIEF JUSTICE MR DM DHARMADHIKARI
and
Hon'ble MR.JUSTICE A.R.DAVE

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

COMMISSIONER OF INCOME-TAX

Versus

KEDRAJ AGRICULTURAL INDUSTRIES

Appearance:
MR BB NAIK with MR MANISH R BHATT for Petitioner
SERVED BY RPAD - (N) for Respondent No. 1

CORAM : CHIEF JUSTICE MR DM DHARMADHIKARI
and
MR.JUSTICE A.R.DAVE

Date of decision: 12/09/2000

ORAL JUDGEMENT(Per: A.R. Dave, J.)

At the instance of the revenue the following two questions of law have been referred to this Court for its

opinion by the Income Tax Appellate Tribunal, Ahmedabad Bench "B" under the provisions of Section 256(1) of the Income Tax Act, 1961 (hereinafter referred to as "the Act").

"1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in coming to the conclusion that for the purposes of calculating relief under Section 80-HH of the Income-tax Act, 1961, the gross profit has to be determined after including therein interest/salary paid by the assessee to its partners which are disallowable under Section 40(b) of the Income-tax Act, 1961?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in coming to the conclusion that the order of rectification passed under Section 154 of the Act by the ITO was liable to be cancelled?"

2. We have heard learned Counsel Mr. Naik appearing for the Revenue. None has appeared for the Assessee.

3. The facts giving rise to the question pertaining to the present case are as under:-

3.1 The assessee is a partnership firm. For the assessment years 1977-78 to 1979-80, the assessee was entitled to a deduction from its profits and gains of an amount equal to 20% thereof under the provisions of Section 80-HH of the Act. As the questions referred to hereinabove are common for all the assessment years, so as to illustrate the facts, we shall look into the relevant figures of income etc. pertaining to the assessment year 1979-80 as the Tribunal has also referred to the factual details of the said year.

3.2 For the assessment year 1979-80, the Assessing Officer restricted the claim under Section 80-HH of the Act to Rs.85,103/-, being the divisible income as determined prior to the adjustment of interest, which was paid to the partners of the assessee firm, which was disallowed under the provisions of Section 40(b) of the Act. It is interesting to note that the assessee firm had paid an amount of Rs.93,558/- by way of interest to its partners. The said amount was initially deducted from the profit of the assessee firm as an expenditure but the said expenditure had been

disallowed by the Assessing Officer under the provisions of Section 40(b) of the Act.

3.3 As the Assessing Officer did not add the sum of Rs.93,558/-, the amount paid to the partners which was disallowed, to the amount of divisible profits for the purpose of giving benefit under Section 80-HH of the Act, the assessee had filed an appeal before the CIT (Appeals). The CIT (Appeals) dismissed the appeal and, therefore, the assessee was constrained to approach the Tribunal. The Tribunal had allowed the appeal and had observed that the assessee could not have been deprived of the benefit under the provisions of Section 80-HH, so far as the amount of Rs.93,558/- was concerned and had directed the Assessing Officer to give the said benefit to the assessee.

4. In the circumstances stated hereinabove, at the instance of the revenue, the question which has been referred to this Court is whether the amount of interest paid by the assessee firm to its partners can be included in the profits of the assessee for the purpose of determining the benefit to be given to the assessee firm under the provisions of Section 80-HH.

5. Section 80-HH, at the relevant time read as under:

5.1 "Where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking, or the business of a hotel, to which this section applies, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, deduction from such profits and gains of an amount equal to twenty per cent thereof."

6. Upon perusal of the said Section, it is clear that while computing the gross total income of the assessee, a deduction of an amount equal to 20% from the profits and gains of the assessee, as determined in accordance with and subject to the provisions of this Section, is to be allowed.

7. Thus, for the purpose of determining the amount of deduction from the gross total income of the assessee, first of all the Assessing Officer has to determine the gross total income of the assessee. The said gross total

income has to be determined in accordance with and subject to the provisions of the said Section.

8. The term "gross total income" has been defined under Section 80B (5). At the relevant time, the term "Gross total income" meant, the total income computed in accordance with the provisions of the Act, before making any deduction under Chapter VI A or under Section 280-O.

9. Thus, for the purpose of determining gross total income of the assessee, the Assessing Officer has to compute gross total income of the assessee as per the provisions of the Act. Relevant sections for the purpose of determining gross total income under the head "Profits and Gains of business or profession" were sections 28 to 44D. Thus, the provisions of Section 40(b) had to be considered by the Assessing Officer for the purpose of determining gross total income of the assessee.

10. As per the provisions of Section 40(b) of the Act, in the case of any firm, certain amounts are not to be deducted in computing the income chargeable under the head "profits and gains of business or profession". Subject to the provisions of the said section, interest paid to the partners is one of such amounts which is not to be deducted. Thus, if any amount is paid by the assessee firm by way of interest to its partners, subject to the provisions of the said section, the amount of interest so paid is not to be deducted as an expenditure for the purpose of computing the income chargeable under the heads of "Profits and Gains of Business or Profession".

11. Looking to the provisions of the Act referred to hereinabove, it is crystal clear that the amount of interest, which was paid by the assessee firm to its partners, which was not allowable as an expenditure, could not have been deducted as expenditure from the gross total income of the assessee or in other words, the said amount of interest paid to the partners of the assessee was not to be deducted as an expenditure and that amount was to be treated as a part of the total income of the assessee.

12. As a result of the aforesaid fact, the amount which was paid to the partners of the assessee firm by way of interest would be treated as part of the "profits and gains of business or profession" and, therefore, the assessee firm would be entitled to a deduction of 20% as per the provision of Section 80-HH of the Act even on the said amount of interest as it was not an allowable

expenditure as per the provisions of Section 40(b) of the Act.

13. In our opinion, the Assessing Officer had committed an error by not allowing deduction to the tune of 20% on the amount of interest as per the provisions of Section 80-HH of the Act read with Sections 80B(5) and 40(b) of the Act. The Tribunal had rightly given benefit under the provisions of Section 80-HH to the assessee by allowing deduction to the tune of 20% of the amount of interest which was paid by the assessee to the partners, as the said amount was forming part of the "profits and gains of business or profession".

14. Thus we are of the view that for the purpose of calculating relief under Section 80-HH of the Act, the gross profit is to be determined after including therein the amount of interest/salary which might have been paid by the assessee firm to its partners and disallowed under the provisions of Section 40(b) of the Act. We, therefore, answer the first question in the affirmative and in favour of the assessee and against the revenue.

15. The second question with regard to the validity of the order of the Tribunal cancelling the order of rectification passed under Section 154 of the Act by the ITO, referred to us at the instance of the revenue, is also answered in the affirmative and in favour of the assessee and against the revenue.

16. Thus, both the questions are answered in the affirmative and in favour of the assessee and against the revenue. The reference thus stands disposed of with no order as to costs.

12-9-2000 (D.M. Dharmadhikari, C.J.)

(A.R. Dave, J.)
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